Shell Exploration & Production Company

One Shell Plaza
P. O. Box 2463
Houston, TX 77252-2463

Larry W. Wooden
Manager Public Affairs

April 26, 1999

Mr. David S. Guzy
Chief, Rules and Publications Staff
Minerals Management Service
Royalty Management Program
Building 85, Room A-613
8th Avenue
Denver Federal Center
Denver, Colorado 80225

Subject: Comments In Response To Minerals Management Service Crude Oil Valuation Rulemaking 64 FR 12267 (March 12, 1999)

Dear Ms. Denett:

On behalf of Shell Exploration & Production Company and its exploration and production subsidiaries and affiliates, Shell Offshore Inc., Shell Deepwater Production Inc., Shell Deepwater Development Inc. (all referred to as Shell), we are pleased to provide additional comments on the Minerals Management Service (MMS) Crude Oil Valuation Rulemaking.

Shell is committed to resolving this matter in a cooperative and expeditious fashion, and we commend the MMS for reopening the rulemaking and conducting three workshops. We believe the workshops furthered the understanding of issues by all parties and are hopeful the dialogue established at those venues will lead to closure on some, if not all, of the issues discussed.

Shell is supportive of the valuation concepts outlined in the American Petroleum Institute, et al comments and offers the following further comments.

Comparable Sales. Shell strongly urges the MMS to expand its valuation methodology options to include comparable sales as a measure of value if the lessee satisfies prescribed information and sales volume requirements. Shell supports the comparable sales model as recommended by industry in the recent workshops and as outlined in comments filed by the American Petroleum

Institute, et al. Such methodology options should be available to the lessee in all producing regions, not just limited to the Rocky Mountain region as currently proposed by MMS.

Shell Exploration & Production Company implemented a tendering program in the Gulf of Mexico in early 1998. Our sole purpose in implementing such a program was to insure obtaining the highest value for production at the lease, which is clearly in the best interest of both lessee and lessor. The bids received in Shell's program are for production at the lease, based on delivery month Platt's averages, and for a bid term of 6 months. Two bid lots are used at each offshore location. Competitive bid lots for 15 percent of equity production are offered and awarded to the highest bidder. The remaining 85 percent of equity production is also competitively bid subject to the right of first refusal by Equilon, Shell Oil Company's downstream joint venture. The purchaser must arrange and pay for transportation and reflect appropriate quality and other costs in its bid. Bids are solicited from a range of companies, large and small, including trading companies, re-sellers, marketers, and refiners. Any qualified bidder is welcome to bid so long as they meet Shell's credit requirements.

Shell's tendering program achieves prices based on competitive commercial terms which include adjustment back to the lease. The use of a tendering program achieves the same goals MMS has sought with the use of a market index without requiring the complexities and uncertainties involved in transportation, quality and location differentials, and tracking through several layers of movement. Since implementation of this program, Shell has seen active, competitive participation by a range of companies, indicating an active market at the lease. Prices received have been in excess of what would have been achieved without such a program, clearly benefiting both lessee and lessor alike.

MMS has expressed concerns regarding industry's proposed minimum threshold volume of 20 percent for a comparable sales program, citing that a minimum volume must insure that some of the lessee's production is "at risk" in addition to the royalty percentage and severance taxes. For offshore, the 20 percent minimum volume clearly meets this criteria. In the offshore no severance taxes apply and the royalty volume varies between 12 ½ percent and 16 2/3 percent, depending upon water depth. Furthermore, current and future production growth in the Gulf of Mexico is in the deep water region where royalty is 12 ½ percent. Consequently, in the offshore the lessee clearly has a portion of production "at risk" under a 20 percent comparable sales program and in the deep water region the lessee's portion approaches that of the MMS.

Shell also has concern that requiring the minimum volume to be too large will lead to lower bid prices. The results of Shell's tendering program indicate that higher prices are offered for the 15 percent portion than for the entire equity portion. This is generally true regardless of production volume, but particularly true in the larger volume leases. Also, even when the percentage tendered is the same, prices received have generally been higher in the smaller volume properties compared to the higher volume properties. Consequently, a comparable sales program with too high a minimum volume would not be in the economic interest of either the lessee or lessor.

Transportation. Shell supports the value of service approach developed and advocated in comments filed by the American Petroleum Institute, et al. While not Shell's preferred outcome, the proposal represents a compromise industry approach that Shell finds acceptable. The proposal avoids the MMS-FERC jurisdictional question and discrimination among shippers while not impacting competition on the OCS.

As a major deep water leaseholder with a large undeveloped leasehold, it is important to Shell that MMS adopt policies that do not discriminate against producers who invest in deep water pipelines. We believe resolution of this issue in a non-discriminatory fashion is important to MMS as well if it wishes to encourage deepwater leaseholders to assume the risk and install the infrastructure necessary to develop remote deepwater discoveries.

In addition to the issues highlighted above, another flaw in the MMS' approach to transportation revolves around the fact that the transportation allowance is inadequate after a pipeline is fully depreciated. While hopeful that the MMS will find the industry compromise proposal or a modification thereto acceptable, we strongly encourage MMS to re-examine this aspect of its approach if the agency decides to proceed with its initial transportation proposal.

Shell strongly encourages MMS to convene a transportation workshop to allow the agency and industry to dialogue further on these very important issues.

Again, let me reiterate our commitment to working cooperatively to resolve issues. Please feel free to contact me at 713-241-0497 if you have questions or if I can be of assistance.

Sincerely,

cc - Ms. Lucy Querques Denett
Associate Director
Minerals Management Service
1849 C Street, N. W.
Washington, D. C. 20240